

Message Text

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ACTION ARA-10

INFO OCT-01 ISO-00 XMB-02 FEA-01 ERDA-05 AID-05 CEA-01

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FM AMEMBASSY LIMA

TO SECSTATE WASHDC 4000

C O N F I D E N T I A L SECTION 1 OF 2 LIMA 1434

DEPT. PLEASE PASS WALTER SAUER, EX-IM BANK

EO 11652: GDS

TAGS: ENRG, EINV, PE

SUBJECT: OCCIDENTAL PETROLEUM IN PERU - AFERMATH OF
HAMMER'S VISIT.

REF: LIMA 1321

1. ON FEBRUARY 18 AN EMBASSY OFFICER REVIEWED IN DETAIL WITH DAVID MARTIN, PRESIDENT OF OXY'S PERU SUBSIDIARY, THE RESULTS OF ARMAND HAMMER'S VISIT LAST WEEK. (REFTEL ERRONEOUSLY CITED MARTIN'S NAME AS MILLER.) MARTIN DISCUSSED CURRENT STATUS OF THROUGH-PUT NEGOTIATIONS, OXY'S VIEWS ON SPUR LINE, OXY'S RELATIONS WITH USG (INCLUDING EX-IM), ITS EXPLORATION PROGRAM, AND GOP STANCE ON THESE ISSUES, AS WELL AS HAMMER'S RECENT PUBLIC ANNOUNCEMENTS TO LIMA PRESS REPORTED BELOW.

2. THROUGH-PUT AGREEMENT - MARTIN, PRIOR TO HAMMER'S ARRIVAL, HAD TECHNICAL LEVEL AT PETROPERU, AFTER SIX MONTHS OF NEGOTIATIONS. MARTIN EXPLAINED THAT ACTUAL
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COST PER BBL. MAY BE LESS THAN \$1.10 (AS REPORTED

REFTEL), SINCE THE OVERALL AGREEMENT IS BASED ON A GRADUAL DECLINE IN PRODUCTION AND A DECLINE IN FIXED YEARLY PAYMENTS, ALTHOUGH THE FIRST YEAR'S AVERAGE WILL BE ABOUT \$20 MILLION FOR AN ESTIMATED 18 MILLION BBL. ANNUALLY. HE SAID THAT COST INCLUDES USE OF PETROPERU'S SPUR LINE IN OXY'S FIELDS AND IS ECONOMICALLY FEASIBLE FROM HIS COMPANY'S POINT OF VIEW. HE NOTED THAT THIS AGREEMENT HAS NOT YET BEEN APPROVED BY PETROPERU'S BOARD OF DIRECTORS, THE MINISTRY OF MINES, OR THE COUNCIL OF MINISTERS. HE SAID APPROVAL COULD TAKE SEVERAL MORE MONTHS SINCE PETROPERU HAS YET TO RECEIVE ITS BIENNIAL BUDGET ALLOCATION. HE ADDED FURTHER THAT NO DECISION ON THE OXY THROUGH-PUT COST OR A FINAL DECISION ON WHO WILL BUILD THE OXY SPUR WILL BE MADE UNTIL THE QUESTION OF REDUCING GASOLINE SUBSIDIES IS RESOLVED BY THE GOP. UNTIL SUCH RESOLUTION, PETROPERU WILL NOT KNOW WHAT ITS BUDGET WILL BE AND THEREFORE WILL NOT MAKE ANY FINAL DECISION ON OXY'S PROPOSALS.

3. COST OF SPUR TO OXY'S FIELDS - ORIGINALLY, MARTIN SAID, THE BECHTEL STUDY HAD PROJECTED A \$160 MILLION COST FOR THIS SPUR, BUT OXY HAS REDUCED THE SIZE OF THE LINE TO 10 INCHES, AND ALSO CHANGED THE "OVER-ELABORATE" BECHTEL DESIGNS, SO THAT THE ACTUAL ESTIMATED COST, AS PER REFTEL, IS \$100 MILLION. THIS LINE WILL BE CAPABLE OF HANDLING 120,000-156,000 BBLS/DAY DEPENDING ON THE VISCOSITY OF THE OIL.

4. OXY'S RATIONALE FOR NOT BUILDING ITS OWN SPUR - MARTIN SAID THERE HAD BEEN CONSIDERABLE CONFUSION OVER THE OXY SPUR, SINCE ORIGINALLY OXY HAD PLANNED TO BUILD IT, AND OXY OBTAINED A LETTER OF INTENT FROM EX-IM BANK TO DO SO. MARTIN SAID THAT OXY OFFICIAL JOE BAIRD LAST YEAR HAD INFORMED EX-IM ORALLY THAT SINCE THE GOP HAD ANNOUNCED IT WAS GOING TO BUILD THE FEEDER-LINE, OXY'S INTEREST BECAME A DEAD LETTER. HOWEVER, HE ALSO NOTED THAT THE LETTER OF INTENT HAS NEVER OFFICIALLY BEEN WITHDRAWN. IN RESPONSE TO A DIRECT QUESTION ABOUT WHY OXY DID NOT DESIRE TO SPEND ANOTHER \$100 MILLION FOR ITS LINE TO SETTLE THE ISSUE ONCE AND FOR ALL, PARTIALLY

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SINCE IT IS ALREADY PLANNING A FURTHER \$260 MILLION IN INVESTMENT, MARTIN GAVE THE FOLLOWING RATIONALE: OXY HAS ACTUAL CONTROL OF ITS RESERVES AND CAN, THEREFORE, ACCEPT THE COMMERCIAL RISK INVOLVED. HOWEVER, SINCE PETROPERU IS BUILDING THE MAIN PIPELINE, OXY WOULD HAVE DIFFICULTY GETTING THE NECESSARY FINANCIAL BACKING FOR A SPUR PIPELINE ON A PIECEMEAL BASIS, PARTICULARLY SINCE OXY WOULD HAVE DIFFICULTY GUARANTEEING THAT

PETROPERU, WHICH IS ALREADY IN THE PIPELINE BUSINESS, WOULD NOT EVENTUALLY TAKE OVER THE SPUR. THUS, OXY (AND BY IMPLICATION, THE BANKS) MAKE A DISTINCTION BETWEEN RISKING INVESTMENT CAPITAL IN FIELDS WITH PROVEN RESERVES AND BUILDING A SPUR LINE. HE SAID THAT SHOULD THE GOP FINALLY DECIDE TO ASK OXY TO BUILD THE SPUR, THEN OXY WOULD HAVE TO RETHINK ALL ITS PROPOSALS. (HE IMPLIED THAT OXY MIGHT RELUCTANTLY BE WILLING TO FIND FINANCING POSSIBLE VIA EX-IM FOR THE SPUR LINE, IF PRESSED, BUT THAT IT OBVIOUSLY DOES NOT WANT TO DO SO.)

5. GOP VIEWS OF OXY (AND HAMMER) - HAMMER CALLED ON PRIME MINISTER MORALES BERMUDEZ AND MINES MINISTER FERNANDEZ MALDONADO. HAMMER GAVE BOTH COPIES OF THE SUMMARY TALKING POINTS WHICH HE ASKED HIS STAFF TO PREPARE PER REFTEL. BOTH MINISTERS RECEIVED HAMMER ENTHUSIASTICALLY AND WERE PLEASED AT HAMMER'S INTEREST AND CONFIDENCE IN PERU. HE NOTED THAT HAMMER'S PUBLIC STATEMENTS TO THE EFFECT THAT OXY WILL INVEST A TOTAL OF \$340 MILLION (CONTRARY TO WHAT HAMMER TOLD THE AMBASSADOR, THE \$340 MILLION INCLUDES OXY'S PRESENT INVESTMENT OF \$80 MILLION) AND THAT THROUGH-PUT PAYMENTS WILL BE \$20 MILLION ANNUALLY, THOUGH REPORTED IN SUNDAY'S FEBRUARY 16 LIMA PRESS, HAD SERVED TO STRENGTHEN OXY'S PUBLIC IMAGE HERE AND THAT, WHILE IT IS SOMEWHAT UNORTHODOX TO ANNOUNCE SUCH FIGURES PUBLICLY, IN THIS CASE HAMMER HAD CHOSE TO DO SO AT A PROPITIOUS MOMENT. MARTIN SAID THAT NEITHER MINISTERS HAD PREVIOUSLY BEEN AWARE OF THE MAGNITUDE OF OXY'S INVESTMENT.

6. GOP PUSHING PETROPERU TO MAKE DECISIONS - MARTIN SAID THAT DURING THE LAST TWO WEEKS THERE HAS BEEN CONFIDENTIAL

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MARKED PRESSURE ON PETROPERU BY THE MINISTRY OF MINES TO MAKE DECISIONS ON OXY'S PROPOSALS. WHILE NO FINAL DECISIONS COULD BE MADE PENDING THE RESOLUTION OF THE BUDGET PROBLEM, HE HAD RECEIVED REQUESTS FROM COFIDE TO AUTHORIZE RELEASE OF COPIES OF THE DEGOLYER AND MCHAUGHTON STUDY OF OXY'S RESERVES (THE LATEST DATES FROM NOVEMBER 1974) TO AL THIRD PARTIES, INCLUDING EX-IM BANK. HE SPECULATED THIS MAY INDICATE THAT PETROPERU IS FINALLY DRAWING TOGETHER THE NECESSARY INFORMATION FOR EX-IM BANK AND THAT HAMMER'S VISIT HAD GALVANIZED THE PERUVIAN BUREAUCRACY TO TAKE A CLOSER LOOK AT OXY'S POTENTIAL ROLE HERE.

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R 201905Z FEB 75

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C O N F I D E N T I A L SECTION 2 OF 2 LIMA 1434

DEPT PLEASE PASS WALTER SAUER, EX-IM BANK

7. OXY'S RESERVE FIGURES - EMBASSY OFFICER POINTED OUT THE DISCREPANCY BETWEEN HAMMER'S ESTIMATE OF 200 MILLION BBLs. OF OXY PROVABLE RESERVES AND THE GOP COMMENTS TO US THAT OXY HAS 300 MILLION BBLs. MARTIN THEN EXPLAINED THAT THE FIRST FIGURE IS BASED ON THE DEGOLYER AND MCNAUGHTON STUDY OF NOVEMBER 1974, WHICH INCLUDES ONLY OXY'S FIRST FIVE STRUCTURES, ACTUALLY DRILLED AT THAT TIME. THE LATTER FIGURE INCLUDES OXY'S "CONSERVATIVE ESTIMATE" FOR ITS SIXTH STRUCTURE, A POTENTIAL PRODUCER, AS WELL AS THE ADDITIONAL SIX STRUCTURES IT WILL BE DRILLING IN THE NEAR FUTURE. HE ALSO SAID OXY WILL SHORTLY CONTRACT WITH DEGOLYER AND MCNAUGHTON FOR A FURTHER CURRENT UPDATED STUDY.

8. OXY'S RELATIONSHIP TO EMBASSY - MARTIN COMMENTED THAT WHILE ALWAYS AVAILABLE TO EMBASSY OFFICERS OUTSIDE OF EMBASSY PREMISES, OXY HAS ATTEMPTED TO MAINTAIN AS "PERUVIAN AN IMAGE AS POSSIBLE" AND, EXCEPT FOR HAMMER'S VISITS TO PERU, OXY OFFICERS PREFER NOT TO VISIT THE

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EMBASSY SINCE PERUVIAN INTELLIGENCE WATCHES EMBASSY VISITORS. IN THIS REGARD, HE SAID THAT ONCE PETROPERU PRESIDENT FERNANDEZ BACA COMMENTED CRITICALLY TO MARTIN THAT ANOTHER COMPANY'S EXECUTIVES, UPON ARRIVAL IN PERU, HAD GONE DIRECTLY TO THE EMBASSY BEFORE CALLING ON PETROPERU. HE SAID HE AND THE OTHER STAFF WELCOME DISCUSSIONS WITH EMBASSY OFFICERS AND THAT HE IN PARTICULAR WOULD LIKE TO BE KEPT CURRENT ON THE STATUS OF THE EX-IM LOAN APPLICATION.

9. "WHY HAS OXY SUCCEEDED WHERE OTHERS HAVE FAILED" - FINALLY, MARTIN SAID THAT OXY'S APPROACH TO SEISMIC WORK (SPEND MORE THAN THE COMPETITORS) (SEE REFTEL) IS ONLY PART OF THE "SUCCESS STORY." HE SAID THE "MAJORS" WHICH INCLUDE MOST OF THE OTHER U.S. COMPANIES IN PERU, DO VERY SPOTTY DRILLING, MEETING THE FIXED SCHEDULE OF THREE OR FOUR WELLS AS CALLED FOR IN THEIR CONTRACTS. GIVEN AN HISTORIC SUCCESS RATION OF TEN TO ONE, IT IS LOGICAL THAT NOTHING HAS YET BEEN FOUND. WHILE NOT PREDICTING THAT OTHERS WON'T FIND OIL, HE SPECULATED THAT OXY'S APPROACH OF MASSIVE "PENETRATION" DRILLING (17 HOLES TO DATE) HAS PAID OFF HANDSOMELY AND THAT THE OTHER COMPANIES, WITH MUCH MORE LIMITED DRILLING PROGRAMS, MAY FAIL TO BE SUCCESSFUL ALTHOUGH THERE IS GOOD GEOLOGICAL EVIDENCE FOR BELIEVING THAT COMMERCIAL QUANTITIES EXIST IN AT LEAST TWO OR THREE OF THE OTHER BLOCKS.

10. COMMENT: IN REGARD TO THE OVERALL TARGET OF \$260 MILLION FOR ADDITIONAL DRILLING AND DEVELOPMENT COSTS, THE EMBASSY IS NOT IN A POSITION TO JUDGE WHETHER THIS FIGURE ACCURATELY REFLECTS OXY'S ACTUAL PLANS. ALTHOUGH MARTIN DID NOT SAY SO, A PREVIOUS OXY OFFICIAL HERE LAST YEAR TOLD AN EMBASSY OFFICER THAT OXY WAS HAVING DIFFICULTY IN RAISING THE NECESSARY CAPITAL FOR THE SPUR LINE AND OVERALL DEVELOPMENT COSTS. THUS, MARTIN'S RATIONALE ABOUT THE DIFFICULTY OF FINANCING THE SPUR MAY WELL BE CORRECT. MARTIN WAS ALSO VERY CANDID ABOUT THE GENERAL HURDLES HIS COMPANY FACES IN OVERCOMING THE INERTIA WITHIN THE GOP TO REACH DECISIONS. HE ALSO OPENLY ADMITTED THAT NOTWITHSTANDING THE COMPANY'S CONFIDENTIAL

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PRESENT CONFIDENCE IN THE STABILITY OF THE GOP AND THE COMPANY'S BELIEF THAT THE GOP WILL HONOR ITS COMMITMENTS, SHOULD OXY BE THE ONLY FOREIGN COMPANY TO FIND OIL, IT COULD EVENTUALLY BECOME A HIGHLY VISIBLE TARGET

FOR NATIONALIST AGITATION.

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